PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Division **RESOLUTION T-16857**
Market Structure Branch **October 7, 2004**

R E S O L U T I O N

Resolution T-16857. Citizens Telecommunications Company of California, Inc. (U-1024-C). Order accepting subject to Commission correction or adjustment, Citizens Telecommunications Company Of California, Inc.'s Annual Intrastate Shareable Earnings Advice Letter in Compliance with Decision 95-11-024.

By Advice Letter No.836 Filed on April 20, 2004.

Summary

Citizens Telecommunications Company of California, Inc.'s (CTC) filed its annual intrastate shareable earnings through Advice Letters (AL) No.836 in compliance with D.95-11-024. CTC reported its intrastate earnings calculation for the twelve months ending December 31, 2003 at 13.01%. As a result of the earnings being in excess of the benchmark rate of return (ROR), CTC's earnings is subject to a 50% refund to ratepayers. The estimated annual revenue effect to be refunded to ratepayers is $2,149,000.

This resolution grants CTC's intrastate shareable earnings advice letter filing, subject to any corrections, adjustments or refunds that result from future Commission decisions or actions.

Background

New Regulatory Framework (NRF)

Pursuant to D.95-11-024, the Commission authorized a new regulatory framework (NRF) for CTC similar to that originally adopted for SBC California and Verizon California, Inc. in D. 89-10-031. The Commission replaced cost-of-service regulation with incentive-based regulation. Commonly known as the "price cap" model, NRF is centered around a price cap indexing mechanism, with sharing of excess earnings above a benchmark rate of return level. The price cap model updates revenues yearly for

inflation and expected productivity improvements for the telecommunications industry.
Under NRF, carriers are given the opportunity to earn a return above that which would be authorized under traditional cost-of-service regulation. In developing a NRF program for CTC, the Commission established two earnings-based safeguards against an improperly functioning indexing mechanism. The Commission set up an earnings floor that protects shareholders against unreasonably low earnings. For CTC, the Commission adopted a floor ROR (6.50%) to provide comparable protection for shareholders in the event that indexing mechanism seriously underestimates revenues needed to provide earnings level reasonably close to the market based ROR.

The Commission also adopted an earnings sharing mechanism to provide a protection to ratepayers from unreasonably excessive profits for the utility. The sharing mechanism employs several ROR thresholds:

> A market-based ROR (9.75%) that reflects what a reasonable market driven ROR would be for a similarly situated utility with comparable risk.
>
> A benchmark ROR 150 basis points (11.25%) higher than a traditional ROR to provide a strong profit incentive to the utility to operate more efficiently. The benchmark ROR is the trigger for sharing excess earnings with ratepayers.
>
> A cap (ceiling) ROR (14.75%) to protect ratepayers against the indexing mechanism that results in unreasonably high prices and excessive profits for the utility.

CTC is required to file an annual advice letter reporting its intrastate earnings for each year to determine whether sharable earnings exist. The filing is required to be made no later than April 1 of the following year. Under the sharing mechanism, CTC retains 100% of its earnings up to the benchmark ROR, shares with ratepayers 50% of its earnings between the benchmark and cap RORs, and refunds to ratepayers 100% of its earnings above the cap ROR.

In D. 00-03-040, which addressed the review of CTC's NRF program, the Commission adopted a settlement between CTC and ORA that:

- Continued the sharing mechanism,
- Continued suspension of the inflation minus productivity (I-X) price cap formula, and
- Eliminated most future Z-factor cost recovery, except for three on-going Z factor items: 1) the Universal Service Fund, 2) Other Billing and Collection, and 3) payphone deregulation.

CTC'S Annual Shareable Earnings Filing

Pursuant to Ordering Paragraph 6 of D. 95-11-024, CTC is required to file its annual intrastate shareable earnings advice letter (AL) by April 1 for the purpose of reporting its actual earned intrastate ROR for the preceding year and determining whether shareable earnings exist. On March 24, 2004, CTC requested an extension until April 19, 2004 to file the annual sharing report. On March 26, 2004, the Commission granted CTC's request for an extension.

On April 20, 2004, CTC filed its intrastate shareable earnings in AL No.836. CTC reported its intrastate earnings calculation for the twelve months ending December 31, 2003 at 13.01%. Other references reported in CTC's filing included the following rates of return:

Market-Based	9.75%
Benchmark	11.25%
Ceiling	14.75%

As a result of the earnings being in excess of the benchmark ROR, CTC's earnings is subject to a 50% refund to ratepayers. CTC estimates the amount to be refunded to ratepayers to be $2,149,000.

Notice/Protests

CTC states that a copy of the AL was mailed to competing and adjacent utilities and / or other utilities and interested parties as requested. Notice of AL No.836 was published in the Commission Daily Calendar of April 26, 2004.

The Commission's Office of Ratepayer Advocates (ORA) filed a timely protest to AL No.836 on May 7, 2004. ORA notes that CTC's 2003 financial statements may reflect cost allocations from both Parent Company and affiliates because CTC is a multi-state telecommunications company. Since its financial statements have not been audited by ORA, it is impossible to verify that the financial report properly reflects the Commission's affiliate transaction rules and accurately reports CTC's earnings.

ORA further notes that an upcoming audit of CTC's books and records for the 3-year period ending December 31, 2003 will be conducted, as ordered by D.04-02-010. Until the completion of the audit, ORA asserts that it is not possible to verify the accuracy of CTC's reported ROR. Following the audit, which would commence within the next few months, ORA believes that CTC's 2003 intrastate shareable earnings are likely to be amended.

ORA recommends that the Commission approve AL No.836, including the attached proposed tariffs and refunding to ratepayers $2,149,000 subject to modification and refund, upon the completion of the audit.

On June 2, 2004, the Telecommunications Division (TD) contacted CTC to inquire whether CTC would be responding to the protest. CTC informed staff that it has not received ORA's protest. On June 3, 2004, TD faxed a copy of ORA's protest to the company. CTC did not file a response to ORA's protest.

Discussion

TD agrees with ORA that the results of the upcoming audit could be used by the Commission to verify the CTC's financial earnings, and concurs with its recommendation to approve AL No.836 subject to modification and refund. TD therefore recommends that the language should state that the CTC intrastate shareable earnings AL filing No.836 be approved, subject to any corrections, adjustments or refunds that may result from future Commission decisions or actions. We agree with TD's recommendation and approve AL No.836 subject to modification and refund.

Comments

In accordance with P.U. Code Section 311 (g) TD mailed a copy of the original draft resolution on September 7, 2004 to CTC and other interested parties. Comments received on a timely basis will be addressed in any final resolution.

No comments were received for this resolution by the Telecommunications Division.

Findings

1) CTC filed an extension to file its intrastate shareable earnings until April 19, 2004. The extension was granted.

2) On April 20, 2004, CTC filed its sharable earnings in AL No.836.

3) CTC reported its ROR for year 2003 was 13.01%.

4) As a result of the earnings being in excess of the benchmark ROR, CTC's earnings is subject to a 50% refund to ratepayers.

5) The estimated annual revenue effect to be refunded to ratepayers is $2,149,000.

6) Information contained in CTC's AL including the reported ROR has not been audited.

7) ORA filed a timely protest on May 7, 2004, recommending that that the Commission approve AL No.836, refunding to ratepayers $2,149,000 subject to modification and refund, upon the completion of an upcoming audit.

8) There are no responses to the protest.

9) No deficiency in AL No.836 has been identified at this time.

10) The reference RORs are as follows:

- Market-Based: 9.75%
- Benchmark: 11.25% (Market-based ROR + 150 basis points)
- Ceiling: 14.75% (Market-based ROR + 500 basis points)
- Floor: 6.50% (- 325 basis points)

11) After reviewing the protest, we conclude the following. We find ORA's protest to be timely. The AL should be approved subject to refund upon any future Commission decisions.

THEREFORE IT IS ORDERED THAT:

1. CTC's Annual Intrastate Earnings Advice Letter No.836 reporting its rate of return for the year 2003 shall be accepted subject to any corrections or adjustments that result from future Commission decisions or actions.

2. CTC shall implement sharing beginning in November 1, 2004. The amount to be refunded to ratepayers to be $2,149,000, over a projected monthly billing base of $2,764,000. CTC shall apply a monthly surcredit of 6.48% to basic monopoly service. This surcredit shall continue until the shareable earnings amount is reached.

This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on October 7, 2004. The following Commissioners approved it:

/s/ STEVE LARSON

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
President
CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY
Commissioners